

EXPLAINER

Risk Transfer Options for the Climate Vulnerable

Disaster risk insurance can help countries in Asia and the Pacific to minimize losses from natural catastrophes.

Introduction

Natural disasters and the effects of climate change pose a serious threat to the sustainable development of many economies in Asia and the Pacific. Between 2007 and 2016, natural hazards in the region have killed more than 300,000 people and affected 1.7 billion more. Direct physical losses are estimated at \$487 billion. Disaster losses are increasing and may even overtake economic growth unless countries take immediate action.

The Asian Development Bank's (ADB) Arup Chatterjee, principal financial sector specialist, explains how disaster risk financing can help countries reduce their vulnerability and minimize their losses. In particular, he talks about the risk transfer options that ADB is looking at to help its member countries.

What are the available financing mechanisms that can help protect countries from natural disasters?

There are a range of options to transfer risk and create more fiscal space for governments, and provide better protection at the household level and small business level.

At the macro level, we are looking at contingent financing mechanisms to help governments protect themselves from the severe aftereffects of a disaster.

At the intermediate level, we are looking at portfolios and businesses where we can support products, such as portfolio insurance for small and medium-size enterprises and agribusinesses.

At the household level, we are looking at a micro-insurance type of mechanism and products, and commensurate regulations.

What role can insurance play in reducing risk and incentivizing climate change adaptation?

Insurance is a tool where they reward the customer by charging a lower premium if they are able to reduce the risk. Customers reduce the risk by improving building codes and bringing in better design and better technology.

With respect to climate change adaptation, insurance can help reduce risks associated with slow onset hazards, such as soil salinization, drought, and land degradation. Agriculture insurance, for example, help protect farmer's income against loss of crops due to climate issues.

What are the key elements in designing a disaster risk insurance framework?

In designing a disaster risk insurance framework, we need a good set of regulations, such as on capital structure (debt-to-equity ratio). An insurance company should remain solvent during a disaster so that it is able to pay claims to the insured.

Second, we need to ensure that there are mechanisms in place to control the intermediaries, agents and brokers, and other technology channels that sell insurance. They sometimes indulge in mis-selling, and therefore insurance regulation should be in place to control market misconduct.

The third area is on corporate governance. Ultimately, risk management is a corporate governance function and therefore insurance companies should have sound corporate governance practices in place to take care of these elements.

All these are captured in the International Association of Insurance Supervisors' core principles. Regulators are encouraged to implement international standards. If you have a sound and robust regulatory environment in place, it will attract international insurers and reinsurers, and foreign direct investment to the market. This will help develop local insurance and reinsurance portfolios in countries.

How is ADB promoting the growth of nascent catastrophe insurance markets?

The insurance market in Asia and the Pacific is in its early stage of development. There is hardly any insurance culture in the region.

In terms of developing the insurance market, ADB is looking at improving the regulatory environment. It is organizing training programs to strengthen the capacity of regulators. ADB is also supporting them in developing insurance regulations and in putting in place an insurance regulatory supervisory system to control the risk.

In terms of product development, ADB is supporting pilots in different emerging market jurisdictions, including projects on crop insurance and micro-insurance. To embark on a pilot, we need to scope the sector and assess the risk first.

Lessons from the pilots in Bangladesh, Mongolia, and Kazakhstan are encouraging, and that will definitely help spur new projects and new types of activities around insurance in those countries.

Resources

Asian Development Bank. 2018. Regional Forum on Strengthening the Enabling Environment for Disaster Risk Financing: Options for Enhancing Financial Resilience. 25–26 September. Manila, Philippines.



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Arup Chatterjee leads financial sector development initiatives in the area of insurance, private pensions and contractual savings, and financial inclusion. He chairs the Joint Working Group of the International Association of Insurance Supervisors and the Islamic Financial Services Board on Microtakaful, and the ADB Working Group on Disaster Risk Financing and Insurance. He sits on the Regulatory Advisory Committee of the Microinsurance Network. An honor graduate in Economics from the University of Delhi, he holds dual Masters in International Economics from the School of International Studies, Jawaharlal Nehru University and in International Business Management from the Indian Institute of Foreign Trade.

Last updated: February 2019